

PEYTO

Exploration & Development Corp.



1999 Annual Report

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Management's Discussion

Year End Review

Production averaged 505 thousand cubic feet (mcf) of natural gas and 39 barrels of oil and natural gas liquids per day for the year. Production gains and higher commodity prices caused operating income to climb to \$411,665. Product prices averaged \$3.16 per mcf for gas and \$22.32 per barrel for oil and natural gas liquids with associated operating costs of \$0.78 per mcf of gas and \$4.43 per barrel of oil. Capital spending totaled \$6,878,399. New discoveries in Sundance, Alberta added 1,953,360 barrels of oil equivalent (boe, 10 thousand cubic feet of natural gas equals 1 barrel of oil) of proven developed reserves at a finding and development cost of \$3.83 per boe. The net present value of Peyto's proven and risked probable additional petroleum and natural gas assets increased 4,346% from \$726,700 to \$32,306,800 (discounted at 15%) by year end.

Peyto had no land holdings or production in Alberta at the beginning of 1999. Developing a core area in West Central Alberta was the primary objective. Sundance, Alberta was targeted as Peyto's first core area because of the abundance of multi-zone, high quality, long term gas opportunities. Peyto had earned over 18,000 net acres (28 sections) of land in the Sundance area at year end.

Peyto drilled and cased or re-entered a total of 9 wells and completed a total of 13 gas zones for an overall success rate of 85%. All of these wells were operated by Peyto and were located in the Sundance area, with the exception of one unsuccessful well located in the Hanlan area of Alberta that was sold in July 1999. The majority of the Company's assets in Sundance were not connected to market at December 31.

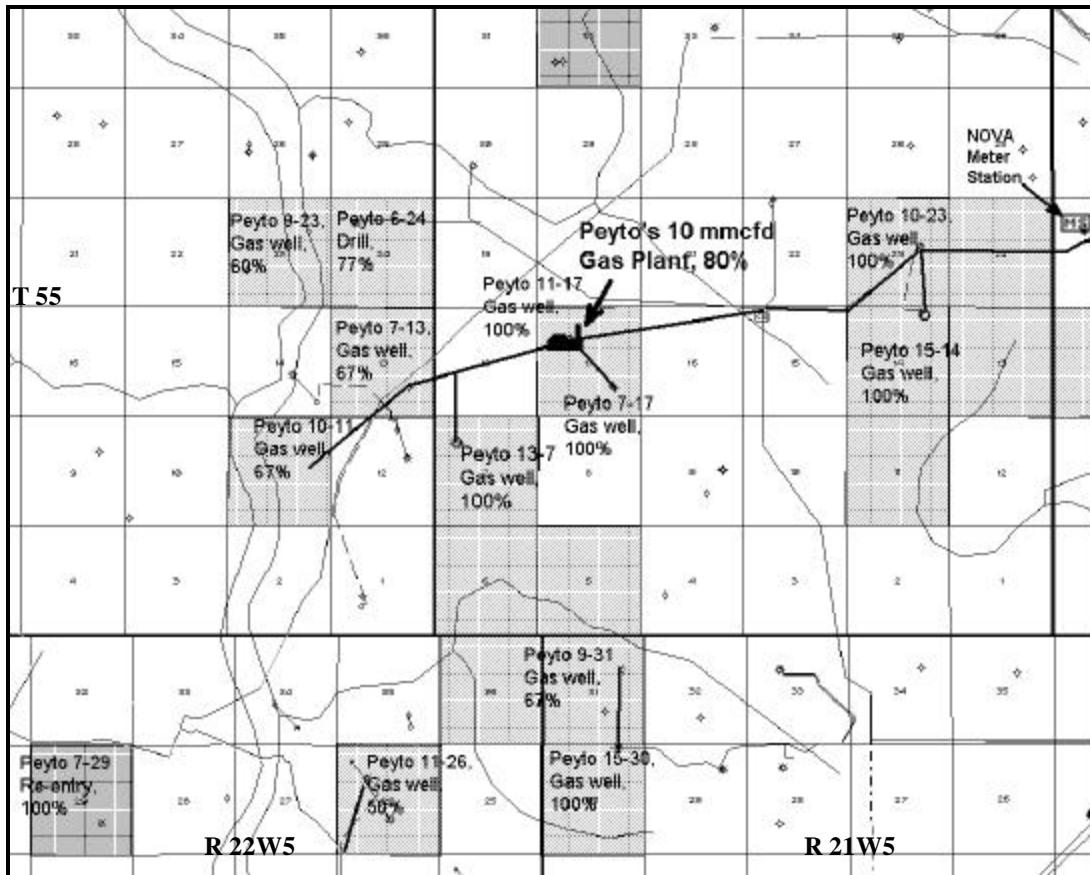
Activity Update

Peyto has been constructing a gas gathering system and processing plant to connect its new reserves in the Sundance area to market over the past couple of months. Peyto operates the new gas plant in which it has an 80% working interest. Current gross capacity at the plant is 10,000 mcf of natural gas and 600 barrels of natural gas liquids per day. The gas plant is now on-stream and is expected to be producing at full capacity by the beginning of May 2000.

Peyto has tied-in and brought on production two additional operated gas wells in the Sundance area to existing gas gathering systems. Current production, excluding the new plant is over 4,500 mcf of natural gas and 150 barrels of oil and natural gas liquids (600 boe) per day. At full capacity, the Company's share of production from the Peyto operated plant will add another 8,000 mcf of natural gas and 350 barrels of natural gas liquids (1,150 boe) per day.

To date in 2000, Peyto has drilled and cased or re-entered a total of 8 wells and completed a total of 7 gas zones for an overall success rate of 86%. These new discoveries will be tied-in following spring breakup.

In two separate transactions, Peyto acquired proven plus risked probable additional reserves totaling \$12,150,000 (discounted at 15%). Over 77% of the reserve value from the transactions with Largo Petroleum Inc. and Eclipse Resources Ltd. is located in wells that Peyto already operates in Sundance.



Sundance Operations Map

Outlook

Peyto is bullish on the prospects ahead. The Company has focused its efforts on establishing and developing its first core area over the past year. With a solid Company operated land and production base, an extensive gas gathering system and a strategically located operated gas plant, Peyto's prospects for wealth creation and growth have never been better. Peyto's success is the result of a focused exploration and development strategy. The Company will move forward with an aggressive infill program on existing proven lands and a fully funded gas exploration and development program focused on further expanding its core area. Visit Peyto's website located at www.peyto.com for more information on the Company.

Don T. Gray, P. Eng.
President & Chief Executive Officer

April 13, 2000

The Team

Don Gray

President & CEO, Director

Professional Engineer, 12 years of oil & gas reservoir, evaluation & exploitation engineering experience

Roberto Bosdachin

Vice President, Exploration

Professional Geologist, 12 years of successful oil & gas exploration experience

Rick Braund

Landman, Chairman

Private Oil & Gas businessman, over 25 years of oil & gas land experience

Sandra Brick

Controller

20 years of oil & gas accounting experience, former Controller of intermediate oil & gas company.

Mark Balen

Operations Engineer

Professional Engineer, 17 years of oil & gas operations, production & reservoir engineering experience

Stephanie Flammenspeck

Technical Assistant

4 years of combined administrative and geological experience

Mike Broadfoot

Director

Head of Engage Energy Canada, a major Canadian gas marketing firm

Brian Craig

Director

CEO of Stormworks Inc., a startup technology company that provides Internet-based solutions to the Canadian market place

Bill Petrie

Director

President of Marengo Exploration Ltd., a junior Canadian oil & gas company

Jim Riddell

Director

Corporate Operating Officer of Paramount Resources Ltd., an intermediate Canadian oil & gas company

Steve Chetner

Corporate Secretary

Securities Lawyer with Burnet Duckworth & Palmer

Operating Data

	Three Months Ended December 31			Year Ended December 31		
	1999	1998	% Change	1999	1998	% Change
Financial						
Revenue						
Cash flow	(79,960)	(63,136)	(27)	22,962	(56,622)	140
Per share	(0.00)	(0.01)	100	0.00	(0.01)	100
Net earnings	(83,084)	(57,969)	43	(91,457)	(57,229)	(59)
Per share	(0.00)	(0.01)	100	(0.01)	(0.01)	0
Capital Expenditures						
Land acquisition	118,489	-	-	172,192	-	-
Seismic	94,997	26,198	263	125,797	26,198	380
Drilling/recompletions	2,021,261	-	-	4,711,347	-	-
Acquisitions	2,251,387	523,100	330	2,251,387	523,100	330
Dispositions	-	-	-	(833,336)	-	-
Facilities	228,041	16,557	1,277	416,677	16,557	2,416
Other	23,342	16,417	42	34,335	16,417	109
Total	4,737,517	582,272	714	6,878,399	582,272	1,081
Production						
Natural gas (mcf /day)	375.90	228.40	65	505.30	114.20	342
Sales price (\$/mcf)	3.37	2.74	23	3.16	2.74	15
Oil & natural gas liquids (bbl/day)	48.00	30.00	60	38.90	15.00	159
Sales price (\$/bbl)	27.89	11.73	138	22.32	11.73	90
Barrels of oil equivalent (10:1, bbl/day)	85.60	53.30	61	89.40	26.40	239
Sales price (\$/bbl)	31.33	18.65	68	28.02	18.65	50
Royalties (\$/bbl)	9.02	5.64	60	9.05	5.64	60
Operating costs (\$/ bbl)	9.44	4.44	113	6.36	4.44	43
Netback (\$/bbl)	12.85	8.57	50	12.61	8.57	47

Operating Data

Reserves

As at December 31	1999	1998	% Change
Natural gas (millions of cubic feet)			
Proven	18,181	674	2,598
Probable	16,535	0	-
Total	34,716	674	5,052
Oil & natural gas liquids (thousands of barrels)			
Proven	806	53	1,427
Probable	780	43	1,706
Total	1,587	96	1,553
Barrels of oil equivalent (10:1, thousands of barrels)			
Proven	2,624	120	2,079
Probable	2,434	43	5,559
Total	5,059	163	2,996

Net Present Value

As at December 31, 1999 (\$)	Discounted at				
	0%	10%	15%	% Change	20%
Proven	57,910,000	27,242,000	22,044,000	3,193	18,702,000
Probable	53,854,000	25,430,000	20,526,000	17,858	17,345,000
Total	111,764,000	52,672,000	42,570,000	5,331	36,047,000

Note:

1999 Reserve & Net Present Value data based on Paddock Lindstrom & Associates Report Dated December 5, 1999.

1998 Reserve & Net Present Value data based on Paddock Lindstrom & Associates Report Dated December 3, 1998.

Operating Data

Net Indebtedness

As at December 31	1999	1998
Long-term debt	1,150,000	-
Less: working capital surplus (deficit)	(646,646)	1,037,596
Total	1,796,646	(1,037,596)

Common Share Data

As at December 31	1999	1998	<i>% Change</i>
Shares outstanding	24,526,642	11,477,834	<i>114</i>
Weighted average shares outstanding			
Basic	14,227,641	5,298,797	<i>169</i>
Fully Diluted	15,532,641	6,244,797	<i>149</i>

FINANCIAL STATEMENTS

**PEYTO EXPLORATION &
DEVELOPMENT CORP.**

December 31, 1999

AUDITORS' REPORT

To the Shareholders of
Peyto Exploration & Development Corp.

We have audited the balance sheet of **PEYTO Exploration & Development Corp.** as at December 31, 1999 and the statements of earnings and deficit and cash flows for the year ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in Canada. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1999 and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in Canada.

The financial statements as at December 31, 1998 and for the six months period then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated July 2, 1999.

Ernst & Young LLP

Calgary, Canada
February 4, 2000

Chartered Accountants

PEYTO Exploration & Development Corp.

BALANCE SHEETS

As at December 31,

	1999	1998
	\$	\$
ASSETS [note 4]		
Current		
Cash	443,725	1,024,686
Accounts receivable	1,291,068	141,149
Prepays	80,346	15,383
	1,815,139	1,181,218
Property, plant and equipment [note 3]	7,322,814	560,680
	9,137,953	1,741,898
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	2,461,785	143,622
Long term debt [note 4]	1,150,000	—
Site restoration and abandonment provision	5,461	2,411
Future income taxes [note 6]	627,257	202,690
	1,782,718	205,101
Shareholders' equity		
Share capital [note 5]	5,041,613	1,449,881
Deficit	(148,163)	(56,706)
	4,893,450	1,393,175
	9,137,953	1,741,898

See accompanying notes

On behalf of the Board:

Director

Director

PEYTO Exploration & Development Corp.

STATEMENTS OF EARNINGS AND DEFICIT

	Year Ended December 31, 1999	Six Month Period Ended December 31 1998
	\$	\$
REVENUE		
Oil and gas sales, net	619,124	62,608
Interest and other income	4,966	5,178
	624,090	67,786
EXPENSES		
Operating	207,457	21,543
Depletion, depreciation and site restoration	119,316	24,002
General and administrative	375,532	102,865
Interest	18,139	—
	720,444	148,410
Loss before taxes	(96,354)	(80,624)
Future income tax recovery	4,897	23,395
(Loss) for the period	(91,457)	(57,229)
(Deficit) retained earnings, beginning of period	(56,706)	523
(Deficit), end of period	(148,163)	(56,706)
Basic loss per share <i>[note 7]</i>	(0.01)	(0.01)

See accompanying notes

PEYTO Exploration & Development Corp.

STATEMENTS OF CASH FLOWS

	Year Ended December 31, 1999	Six Month Period Ended December 31 1998
	\$	\$
Cash provided by (used in)		
OPERATING ACTIVITIES		
Loss for the period	(91,457)	(57,229)
Items not requiring cash		
Future income taxes	(4,897)	(23,395)
Depletion, depreciation and site restoration	119,316	24,002
Funds from operations	22,962	(56,622)
Change in non-cash working capital from operations	(160,000)	(15,410)
	(137,038)	(72,032)
FINANCING ACTIVITIES		
Issue of common shares, net of costs	2,712,105	989,783
Increase in long term debt	1,150,000	—
	3,862,105	989,783
INVESTING ACTIVITIES		
Additions to property, plant and equipment	(4,306,028)	(328,221)
Net increase (decrease) in cash	(580,961)	589,530
Cash, beginning of period	1,024,686	435,156
Cash, end of period	443,725	1,024,686
Funds from operations per common share <i>[note 5]</i>	0.00	(0.01)

See accompanying notes

PEYTO Exploration & Development Corp.

NOTES TO FINANCIAL STATEMENTS

Year ended December 31, 1999

1. NATURE OF OPERATIONS

Peyto Exploration & Development Corp., (formerly Desco Resources Ltd.) (the "Company") is engaged primarily in the exploration for and production of petroleum and natural gas in Western Canada.

At the Annual and Special Meeting of the shareholders on October 22, 1998, the shareholders approved the Company's major transaction as defined in Alberta Securities Commission Rule 46-501, being the purchase of various petroleum and natural gas properties in Saskatchewan.

The Company has changed its year end to December 31 and these financial statements reflect its operations for the year ended December 31, 1999 with comparatives for the six month period ended December 31, 1998.

Major transactions

The purchase price of \$508,100 was comprised of \$254,050 in cash and \$254,050 by issue of 1,693,667 common shares at a deemed price of \$0.15 per share.

The purchase was from three parties, two of which were related parties by virtue of common directors, officers and shareholdings. The purchases were recorded at exchange amounts. Details of the acquisition are as follows:

Vendor	Cash \$	Shares \$	Total \$
Viewpoint Resources Ltd. (related)	90,700	90,700	181,400
Marengo Petroleum Corporation (related)	43,000	43,000	86,000
Evermount Resources Ltd.	120,350	120,350	240,700
	254,050	254,050	508,100

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with accounting principles generally accepted in Canada and a summary of policies follows:

a) Joint operations

The Company conducts substantially all of its oil and gas exploration and production activities jointly with others and, accordingly, these financial statements reflect only the Company's proportionate interest in such activities.

PEYTO Exploration & Development Corp.

NOTES TO FINANCIAL STATEMENTS

Year ended December 31, 1999

b) Property, plant and equipment

(i) Capitalization of costs

The Company follows the full cost method of accounting for its petroleum and natural gas operations. All costs related to the exploration for and development of petroleum and natural gas reserves are capitalized. Costs include lease acquisition costs, geological and geophysical expenses and costs of drilling both productive and non-productive wells.

Proceeds from the disposal of properties would usually be applied against capitalized costs, without any gain or loss being realized, unless the disposal results in a change in the depletion rate of greater than 20% in which case a gain or loss on disposal will be recorded.

(ii) Depletion and depreciation

Depletion of petroleum and natural gas properties and depreciation of production equipment is provided using the unit-of-production method based upon estimated proved petroleum and natural gas reserves as determined by independent engineers. The cost of significant unevaluated properties are excluded from costs subject to depletion. For depletion and depreciation purposes, relative volumes of petroleum and natural gas production and reserves are converted at the energy equivalent conversion rate of six thousand cubic feet of natural gas to one barrel of crude oil.

Office furniture and equipment are depreciated over their estimated useful lives at declining balance rates between 20% and 30%.

(iii) Ceiling test

In applying the full cost method, the Company calculates a ceiling test whereby the carrying value of petroleum and natural gas properties and production equipment, net of recorded future income taxes and the accumulated provision for site restoration and abandonment costs, is compared annually to an estimate of future net revenue from the production of proved reserves. Net revenue is estimated using year end prices, less estimated future general and administrative expenses, financing costs and income taxes. Any reduction in value as a result of the ceiling test will be charged to earnings as additional depletion and depreciation.

c) Future site restoration and abandonment costs

Estimated future costs relating to site restoration and abandonment are accrued on a unit of production basis. Costs are estimated, net of expected recoveries, based upon current prices, legislation, technology and industry standards. The annual provision is recorded as additional depletion and depreciation. The accumulated provision is classified as a non-current liability and actual expenditures will be charged against the accumulated provision as incurred.

PEYTO Exploration & Development Corp.

NOTES TO FINANCIAL STATEMENTS

Year ended December 31, 1999

d) Flow-through common shares

Resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. The estimated tax benefits transferred to shareholders are recorded as future income taxes and reduced share capital is recorded when the expenditures are renounced.

e) Financial instruments

Financial instruments of the Company consist of cash, accounts receivable, accounts payable and accrued liabilities and long term debt. As at December 31, 1999 there are no significant differences between their carrying values and their estimated market values.

f) Measurement uncertainty

The amount recorded for depletion of oil and gas properties is based on estimates. The ceiling test calculation is based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future years could be significant.

g) Future income taxes

The Company follows the liability method of tax allocation. Under this method future income tax assets and liabilities are determined based on differences between financial reporting and income tax bases of assets and liabilities, and are measured using enacted tax rates and laws that will be in effect when the differences are expected to reverse. The effect on future income tax assets and liabilities of a change in tax rates is recognized in earnings in the period in which the change occurs.

h) Stock based compensation plan

The Company has a stock based compensation plan. Consideration paid by employees or directors on the exercise of stock options is credited to share capital. As options are issued at current market value, the option has no intrinsic value, therefore no compensation expense is recorded.

PEYTO Exploration & Development Corp.

NOTES TO FINANCIAL STATEMENTS

Year ended December 31, 1999

3. PROPERTY, PLANT AND EQUIPMENT

	December 31, 1999	December 31, 1998
	\$	\$
Property, plant and equipment	7,409,919	565,855
Office furniture and equipment	50,752	16,416
	7,460,671	582,271
Accumulated depletion and depreciation	(137,857)	(21,591)
	7,322,814	560,680

No general and administration expenses relating to the Company's exploration, development and acquisition programs were capitalized.

4. LONG TERM DEBT

The Company has a revolving operating credit facility to a maximum of \$1,750,000 under which it can borrow at bank prime plus $\frac{3}{4}$ % per annum. As collateral, the Company has provided a general assignment of book debts and a \$2,500,000 floating charge debenture over all assets and fixed charges over the Company's producing properties at Milton/Smiley, Saskatchewan. The bank has stated that provided there is no adverse change in the Company's financial position, it is not their intention to call for repayment of the loan. Accordingly the loan is classified as long term.

On January 14, 2000 the credit facility was increased to an operating line of \$4,500,000 and a development line of \$750,000.

PEYTO Exploration & Development Corp.

NOTES TO FINANCIAL STATEMENTS

Year ended December 31, 1999

5. SHARE CAPITAL

Authorized

Unlimited number of common voting shares
Unlimited number of preferred shares, issuable in series

Issued - Common shares

	Number of Shares	Amount \$
Balance, July 1, 1998	3,750,000	462,402
Issued for cash	2,766,667	415,000
Issued for property on major transaction <i>[note 1]</i>	1,693,667	254,050
Issued for cash on flow-through shares	3,267,500	653,500
Tax benefits transferred to shareholders	—	(291,461)
Share issue costs, net of associated tax benefits	—	(43,610)
Balance, December 31, 1998	11,477,834	1,449,881
Issued for cash by private placement	1,485,387	267,370
Exercise of stock options	145,450	29,090
Issued for property acquisition	4,363,636	1,309,091
Rights offering - flow-through shares	1,524,813	564,181
Rights offering	5,029,522	1,508,856
Issued for cash on flow through shares	500,000	425,000
Share purchase loan to an officer	—	(40,000)
Tax benefits transferred to shareholders	—	(448,693)
Share issue costs, net of associated tax benefits	—	(23,163)
Balance, December 31, 1999	24,526,642	5,041,613

a) On November 3, 1999, the Company completed a rights offering, issuing 6,554,335 common shares to the rights holder for gross proceeds of \$2,073,037, less \$42,392 issue costs. The offering included 5,029,522 common shares at \$0.30 per share and 1,524,813 flow-through common shares at \$0.37 per share.

PEYTO Exploration & Development Corp.

NOTES TO FINANCIAL STATEMENTS

Year ended December 31, 1999

b) The Company purchased three unconnected gas wells that it currently operates and plans to bring on production and some strategic undeveloped land for \$1,409,091, consisting of 4,363,636 common shares at an ascribed price at \$0.55 per share and the remaining \$100,000 in cash. For accounting purposes the shares issued have been recorded at \$0.30 per share being an amount consistent with the cash price received for shares in the November 3, 1999 rights offering. The transaction closed on December 17, 1999.

Stock Options

The Company has a director and employee stock option plan. The number of common shares reserved for issuance at any one time shall not exceed 10% of the issued and outstanding common shares.

The Company has the following director, employee and agent stock options outstanding:

Grant Date	Expiry Date	Price	Number of Shares	
			December 31, 1999	December 31, 1998
March 31, 1997	January 23, 1999	\$0.20		100,000
October 10, 1997	June 8, 1999	\$0.20		125,000
December 9, 1998	December 9, 2003	\$0.15	721,000	721,000
January 12, 1999	January 12, 2004	\$0.25	584,000	—

Subsequent to December 31, 1998, 145,450 of the \$0.20 options were exercised and the balance have expired.

6. INCOME TAXES

The liability for future income taxes is primarily due to the excess carrying value of property plant and equipment over the associated tax basis.

PEYTO Exploration & Development Corp.

NOTES TO FINANCIAL STATEMENTS

Year ended December 31, 1999

The actual income tax provision differs from the expected amount calculated by applying the Canadian combined federal and provincial corporate tax rates to earnings before income taxes. The majority of these differences are explained as follows:

	1999	1998
	\$	\$
Income before income taxes	(96,354)	(80,624)
Statutory income tax rate	45.36%	44.62%
Expected income taxes	(43,706)	(35,974)
Increase (decrease) in income taxes from:		
Non-deductible crown charges	86,047	7,911
Resource allowance	(33,965)	2,498
Corporate income tax rate change	3,361	
Attributed Canadian royalty income	(23,609)	2,660
Other	6,975	(490)
Recovery for income tax	(4,897)	(23,395)

At December 31, 1999 the Company has incurred losses for income tax purposes of \$483,999 (December 30, 1998 - \$71,343) which have been reflected in these financial statements. These losses will expire as follows:

2004	\$ 13,643
2005	\$ 57,700
2006	\$412,656

7. PER SHARE AMOUNTS

Loss per share and funds used in operations per share have been calculated based upon the weighted average number of common shares outstanding during the year of 14,227,641 (1998 - 5,298,797). Fully diluted loss per share is not shown since the issue of the shares upon the exercise of the options and warrants would be anti-dilutive.

8. SUBSEQUENT EVENTS

Debenture financing

On January 24, 2000 the Company issued a \$2,700,000 convertible subordinated secured debenture due December 1, 2004 and bearing interest at 3.0% per annum. The debenture will be convertible into common shares at the option of the holder at any time prior to maturity at a price of \$0.60 per share, subject to regulatory approval. The Company can redeem the debenture at the

PEYTO Exploration & Development Corp.

NOTES TO FINANCIAL STATEMENTS

Year ended December 31, 1999

issue price at any time after July 1, 2000 if the trading price of the common shares over the previous fifteen trading days exceeds \$0.84 share. For accounting purposes, the fair value of the debenture, exclusive of the conversion feature, is estimated at \$1,565,064, using a 15% effective interest rate. The \$1,134,936 difference between the \$2,700,000 and the estimated fair value of the debenture will be recorded as contributed surplus.

Offer to purchase

The Company issued a take-over bid circular dated December 23, 1999 to purchase all of the common shares of Largo Petroleum Inc. ("Largo") on the basis of .50 of a common share of the Company for each one of the 13,207,510 common shares of Largo. As of January 27, 2000, 90 percent of Largo's shares had been deposited under the offer.

Stock options

On January 10, 2000 the Company issued 330,000 options at an exercise price of \$0.48 and 813,000 options at an exercise price of \$0.52 to employees and directors of the Company, with expiration dates of January 10 and January 18, 2005 respectively.

Corporate Information

Management

Don T. Gray, P.Eng.
President and Chief Executive Officer

Roberto Bosdachin
Vice-President, Exploration

Sandra Brick
Controller

Steve Chetner
Corporate Secretary

Directors

Rick Braund
Chairman of the Board

Don T. Gray
Director

Mike Broadfoot
Director

Bill Petrie
Director

Brian Craig
Director

J.H.T. Riddell
Director

Auditors Ernst & Young

Solicitors Burnet Duckworth & Palmer

Bankers National Bank of Canada

Transfer Agent Montreal Trust Company of Canada

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